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Further Legal Determinants of External Finance in Scotland: an Intra-UK Market for Incorporation?

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A. INTRODUCTION

In the 2017 edition of this journal, the author deployed¹ a law and finance approach² to attracting more external finance to Scotland. The author established a transaction cost framework³ for future commercial law reforms. The author argued that, in a corporate setting, the two relevant sources of external finance are debt or equity, and applied that framework to debt finance only. Equity finance was ignored as “laws in respect of the constitution of corporate vehicles and capital markets are the same.”⁴ Whilst there are

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¹ J Hardman, “Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge” (2017) 21(1) EdinLR 30.

² R La Porta, F Lopez-de-Silanes, A Shleifer and R W Vishny, “Law and finance” (1998) 106(6) Journal of Political Economy 1113; R La Porta, F Lopez-de-Silanes, A Shleifer and R W Vishny, “Legal determinants of external finance” (1997) 52(3) Journal of Finance 1131; R Haslemann, K Pistor and V Vig, “How law affects lending” (2010) 23(2) The Review of Financial Studies 549.

³ R H Coase, “The problems of social cost” (1960) 3 J L & Econ 1; P Schlag, “The problem of transaction costs” (1989) 62 Southern Carolina Law Review 1661; A M Paccès and L Visscher, “Methodology of Law and Economics” in B van Klink and S Taekema (eds), *Law and Method. Interdisciplinary Research into Law* (2011) at 85-107.

⁴ Hardman (n 1) at 42.

minor differences between the two jurisdictions, the academic conventional wisdom is that English and Scottish company law mostly align.⁵ Grier's *Company Law* even states:

To take account of the increasing dominance of English law, this book will frequently refer to English law. While technically many English cases may not be binding on Scots law, it is clearly pointless for a small island to have widely diverging commercial/legal practices depending on which side of the Tweed one may happen to be, and consequently much regard is paid to English cases. This book will follow this precept.⁶

But if this is the conventional wisdom, is it correct? Recent research has identified that the Scottish corporate form is in trouble. Only five Scottish companies currently listed on the London Stock Exchange have been admitted to the exchange since 15 September 2008,⁷ the date that Lehman Brothers collapsed.⁸ By way of comparison, 539 English companies have been admitted to the exchange since such date. Evidence shows that 36% of Scottish non-investment companies⁹ have their headquarters in England. On the other hand, only

⁵ English texts differentiate Scots law only where areas of explicit difference apply, leaving the implication of unity between company law elsewhere (E.g. P L Davies and S Worthington, *Gower Principles of Modern Company Law*, 10th edn (2016) at para 2-9, footnote 19; G Morse et al (eds), *Palmer's Company Law*, release 163 (2019) at para 13-410). Moore has stated "The UK by contrast, in spite of being comprised of two traditionally autonomous legal systems and four separate national legislatures today, nonetheless by and large exhibits a unitary corporate law system" - M T Moore, "Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism" (2014) 34 OJLS 693 at 709. Scots texts make similar statements, e.g. D Bennett, "Companies", in *The Laws of Scotland: Stair Memorial Encyclopaedia*, Reissue (2013) at para 1.

⁶ N Grier, *Company Law*, 5th edn (2020) at para 1-29.

⁷ J Hardman, "The Slow Death of the Scottish Company Listed in London: An Empirical Study" JBL (forthcoming); [dataset] J Hardman, "UK Companies listed on the London Stock Exchange as at 30 June 2020 by jurisdiction", 2020 available at <https://doi.org/10.7488/ds/2898>.

⁸ See C Hofmann, "Central bank collateral and the Lehman collapse" (2011) 6 CMLJ 456; A Ewins, C Husted, J Lee and J Woo, "The Lehman Aftermath: Hong Kong and Singapore Regulatory Reforms in the Structured Product Markets World" (2010) 5 CMLJ 301.

⁹ This was measured by membership of the Association of Investment Companies - available at <https://www.theaic.co.uk/aic/find-compare-investment-companies>. Investment companies were excluded because they are likely to have no employees nor permanent operations independent of their manager – see Davies and Worthington (n 5) at paras 6.18-6.19.

c0.5% of English companies have their headquarters in Scotland. Worse, since the date of the Lehman Brothers collapse, more Scottish headquartered companies incorporated in England and Wales have had their shares admitted to the London Stock Exchange than Scottish headquartered companies incorporated in Scotland.¹⁰

In addition, it is possible that there is a fundamental theoretical difference in the origin of corporate legal personality between English and Scots law. The legal fiction/state gift theory¹¹ appears (despite previous arguments to the contrary¹²) dominant in England.¹³ This holds that separate corporate legal personality is a legal fiction, whose boundaries are set by the state. Conversely, the real entity theory¹⁴ applies north of the Tweed.¹⁵ This holds that separate corporate legal personality arises organically. The origin of separate legal personality identifies the locus of the state to intervene in the activities of the company. If corporate separate legal personality arises by way of a gift from the state, then the state's locus for intervention is higher than if it arises organically.¹⁶ As such, the state needs less justification to intervene in the workings of companies if their personality arises by way of gift from the state. Extrapolations from these theoretical positions could result in doctrinal

¹⁰ Hardman (n 7) at section 3(C)(ii).

¹¹ R Harris, "The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Business" (2006) 63 Wash&LeeLR 1421; H Hansmann and R Kraakman, "The Essential Role of Organizational Law" (2000) 110 YaleLJ 387.

¹² F W Maitland, "The Corporation Sole" (1900) 16 LQR 355; F W Maitland, "The Crown as Corporation" (1901) LQR 131; F Pollock, "Has the Common Law Received the Fiction Theory of Corporations" (1911) 27 LQR 219.

¹³ S M Watson, "The Corporate Legal Person" (2019) 19 (1) JCLS 137.

¹⁴ J E Friedlander, "Corporations and Kulturkampf: Time Culture as Illegal Fiction" (1996) 31 ConnLRev 31 at 78; Harris (n 11) at 1425.

¹⁵ J Hardman, "Reconceptualising Scottish Limited Partnership Law" (2020) JCLS. DOI: 10.1080/14735970.2020.1803784.

¹⁶ P G Mahoney, "Contract or Concession? An Essay on the History of Corporate Law" (2000) 34 GaLR 873; Friedlander (n 14).

company law differences between the two legal systems being more material than previously acknowledged.

The purpose of this article is to explore whether there could be any company law reasons for the decline of the Scottish listed company: in other words, the equity aspect of external finance. Listing rules apply equally to all companies listed on the London Stock Exchange, regardless of their jurisdiction of incorporation.¹⁷ There are no restrictions between the activities of companies intra-UK: a Scottish company and an English company can both freely trade within the UK, and trade on the same terms external to the UK.¹⁸ Accordingly, any legal causes for the comparative decline of Scottish companies being listed in London must arise due to company laws.¹⁹ Company law concepts frequently derive from private law concepts. As such, we need to examine these company law concepts and the private law concepts from which they derive. This article will therefore explore differences between English and Scottish company law (often extrapolated from private law concepts), whether these have an impact on transaction costs between the parties, and whether these could lead to the Scottish corporate form being eschewed for the English company.

This conception of company law driving jurisdiction of incorporation is not novel. In the US, a large body of literature has developed based on a conception of a “market for incorporations”. This concept follows the observation that parties can incorporate their

¹⁷ See Listing Rules (available at <https://www.handbook.fca.org.uk/handbook/LR.pdf>), Rules 1.1.1 and 1.4.

¹⁸ Accordingly it is not a driver of intra-UK legal competition – see discussion in Part B.

¹⁹ For discussion of the interaction between listing rules and non-domestic company laws see I MacNeil and A Lau, “International Corporate Regulation: Listing Rules and Overseas Companies” (2001) 50(4) ICLQ 787; B R Cheffins, “The Undermining of UK Corporate Governance (?)” (2013) 33(3) OJLS 503.

company in any jurisdiction they like.²⁰ As such, there forms a “market” for incorporations as shareholders and directors choose the jurisdiction which best meets their needs – the act of incorporating somewhere is akin to purchasing that jurisdiction’s product.²¹ The phrases “market for incorporations” and “market for corporate law” are interchangeable.²² Under US law, each state has its own statute of incorporations and so the act of choosing which state to incorporate in provides such a market.²³ It is possible that the same mechanics apply intra-UK, and have resulted in the decline in the listing of Scottish companies on the London Stock Exchange.

A market for incorporations requires both basic market conditions (demand from market participants and supply of different laws) and a legal framework (are there differences between the two jurisdictions?).²⁴ The latter tells us whether the mechanics exist for a market for incorporation, the former whether market participants will actually use such a mechanism. We shall therefore explore whether this applies intra-UK. Given empirical evidence that Scottish headquartered companies are more likely to list using English legal vehicles, it seems some form of demand exists. Therefore, this article is focused on whether law provides supply for the market for incorporations (are there differences between English and Scottish company law?), and whether the legal framework exists. We shall also establish

²⁰ R Romano, “Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws” (1989) 89 ColumLR 1599.

²¹ R Romano, “Law as a Product: Some Pieces of the Incorporation Puzzle” (1985) 1 JLEcon&Org 225.

²² See D S Schaffer, “Delaware’s limit on director liability: how the market for incorporation shapes corporate law” (1987) 10(3) HarvJL&PubPoly 665; O Bar-Gill, M Barziza and L Bebchuk “The Market For Corporate Law” (2006) 162(1) JITE 138.

²³ B H McDonnell, “Sticky Defaults and Altering Rules in Corporate Law” (2007) 60 SMULRev 383 at 422. Delaware is, by far, the most popular jurisdiction for incorporations, although most companies incorporated there are not headquartered in Delaware – see L A Bebchuk, “Federalism and the Corporation: the Desirable Limits on State Competition in Corporate Law” (1992) 105 HarvLR 1437 at 1443.

²⁴ L E Ribstein, “Delaware, Lawyers and Contractual Choice of Law” (1994) 19 DelJCorpL 999 at 1007; B R Cheffins, *Company Law Theory, Structure and Operation* (2008) at 426; W L Cary “Federalism and Corporate Law: Reflections Upon Delaware” (1974) 83 YaleLJ 633.

the likely transaction costs of any differences. This will help us explore whether transaction costs have driven such demand. In other words, we will explore whether comparatively high transaction costs can explain the decline in the Scottish listed company. The results present a clear picture. Transaction costs differences arising from known differences in company law are low. Differences arising from the implicit private law principles on which those known differences are based are higher. The highest transaction costs differences are those arising from the uncertainty of not knowing whether Scots law will follow English conceptions or extrapolate from Scots private law rules. A framework for the market for incorporations exists intra-UK, meaning that the concepts of the market for incorporations could explain the decline in the use of the Scottish corporate vehicle for listings.

The next three Sections will explore the supply aspect of the market for incorporations. Section B explores basic concepts and known differences between English and Scots company law. Section C argues that one of these known differences, the difference in taking security over shares, arises because of an implicit difference in the nature of a share. Section D explores the Duomatic principle of company law, and argues that it may not apply in Scotland. The examples used in Sections C and D are illustrations of wider concepts. Having identified that there are differences between English and Scots law, and that utilising English law provides lower transaction costs, Section E explores whether the framework exists for a market for incorporation between the two jurisdictions. Section F concludes.

B. SUPPLY: KNOWN DIFFERENCES

Companies incorporated in both Scotland and England are governed by the same Act.²⁵

This approach is not unusual across commercial law. A raft of Scottish commercial law is based on a codifying statute that applies both to England and Scotland. Most of these

²⁵ Companies Act 2006 s 1.

codifications occurred in the late Victorian era: particularly of note are partnership²⁶ and sale of goods.²⁷ These have long been criticised by Scottish commentators. T B Smith stated that they represented the “imposition of a foreign law” on Scotland.²⁸ Lord Rodger of Earlsferry provided the more nuanced statement that Scottish doctrinal considerations were ignored in the drafting of the relevant Acts.²⁹ Certainly, the draftsman of the Sale of Goods Act 1893 considered it to codify existing law rather than to represent any idealistic statement as to what the law should be.³⁰ For Scots law, however, its terms were innovations which changed the law.

Comments about such codification statutes being based on English legal concepts and applied to Scots law without sufficient consideration still resound today.³¹ However, even within such codified statutes, there are differences in interpretation between the two statutes on subjects of universal application, even where the same provision applies.³² As such, English and Scottish company law being governed by the same Act does not preclude different laws applying. There are, of course, differences in the nature of these codifying

²⁶ Partnership Act 1890.

²⁷ Sale of Goods Act 1893; now repealed and ultimately replaced with the Sale of Goods Act 1979.

²⁸ T B Smith, “Pretensions of English Law as ‘Imperial Law’”, in *The Laws of Scotland: Stair Memorial Encyclopaedia* vol 5 (1987) at paras 711 – 719, in particular the discussion of mercantile law developments in para 717.

²⁹ A F Rodger, “The codification of commercial law in Victorian Britain” 1992 LQR 570 at 571. Rodger argues that unifying statutes were pushed by Scottish businessmen trying to create the ideal commercial environment for themselves, rather than having English law thrust upon them (at 572-582).

³⁰ M D Chalmers, “Codification of Commercial Law” (1902) 25 Annual Reports of the American Bar Association 282 at 283; M D Chalmers, “Experiment in Codification” (1886) 2 LQR 125.

³¹ For partnership, see L Macgregor “Partnership and legal personality: cautionary tales from Scotland” (2020) 20 JCLS 237 at 255; for sale of goods, see A Rahmatian, “Sale of Goods”, in I G MacNeil (ed) *Scots Commercial Law* (2014) at para 6.03.

³² E.g. differences on the right of repair under Sale of Goods Act 1979 s 35 – which may arise in Scotland under a gratuitous contract - *J&H Ritchie v Lloyd Ltd* [2007] UKHL 9; 2007 S.L.T. 377 at [34]. This creates a difference between English and Scots law – see P Hood, “A stitch in time? Repairs and rejection in Sale of Goods” (2008) 12 EdinLR 316; J M Thomson, “A simple case? *J&H Ritchie Ltd v Lloyd Ltd*, 2007 S.L.T. 377” [2007] JurRev 241 at 246.

statutes from company law. The biggest difference is that they provided general statements of (in England) pre-existing law.³³ On the other hand, for English law, original Companies Acts created a brand new type of legal entity.³⁴ From a Scots law perspective, this meant that the codifying statutes supplanted existing laws.³⁵ However, companies legislation was initially ignored in Scotland as Scottish partnerships already experienced separate legal personality. As such, early companies legislation had a bigger effect for English law than it did for Scots law.³⁶ Accordingly, the disruption of existing laws caused by the codifying laws was greater in Scotland than the disruption caused by the companies legislation was. Nevertheless, the examples of partnership law and sale of goods law demonstrate that the mere presence of a single Act governing English and Scots law does not result in inevitable alignment of legal rules. Within company law, there has been a general convergence of known non-convergent areas: one major difference, registration of rights in security, converged in 2013.³⁷

Seven primary differences are known and acknowledged between the two jurisdictions. First, the rules for raising a derivative claim/procedure³⁸ on behalf of a company against a wrongdoing director differ between English law and Scots law.³⁹ Scots law requires two

³³ See F Pollock, “English Private Law 1879-1920” (1924) CambLJ 19 at 36.

³⁴ See S M Watson, “The Corporate Legal Person” (2019) 19 JCLS 137.

³⁵ See discussion in sources referenced in (n 28; n 29).

³⁶ See F Clark, *A Treatise on the Law of Partnership and Joint-Stock Companies According to the Law of Scotland* (1866) at 6; J Robertson Christie, “Joint Stock Enterprise in Scotland Before the Companies Acts” (1909-1910) 21 JurRev 128 at 129.

³⁷ See Companies Act 2006 ss 859A-859G; A D J MacPherson, “Registration of Company Charges Revisited: New and Familiar Problems” (2019) 23 EdinLR 153; H Patrick “Charges Changing” 2013 JLSS (February).

³⁸ J Armour, “Derivative actions: a framework for decisions” (2019) 135 LQR 412; D Kershaw, “The rule in Foss v Harbottle is dead: long live the rule in Foss v Harbottle” [2015] JBL 274. A derivative claim/procedure is the ability of shareholders to sue a wrongdoing director on behalf of the company, with any proceeds from such claim being received by the company rather than the suing shareholder.

³⁹ See Companies Act 2006 ss 260-264 for the English rules and ss 265-269 for the Scottish rules.

court processes; English law one.⁴⁰ This seems to cause higher transaction costs for Scotland. However, derivative claims are rarely used.⁴¹ This makes the procedure, and any transaction costs arising due to jurisdictional differences in its operation, very unlikely to be a driver of incorporation. Second, corporate insolvency rules are different.⁴² Recent reforms to Scottish rules, however, were designed to align to English rules as much as possible.⁴³ Nevertheless, differences remain between the two insolvency regimes. For example, English law has a public body, the Official Receiver, which acts as a liquidator-of-last-resort for a company.⁴⁴ Scots law does not have a body which fulfils such a function.⁴⁵ Similarly, whilst liquidators of English companies are clearly able to disclaim onerous contracts,⁴⁶ liquidators of Scottish companies do not enjoy exactly the same right.⁴⁷ However, the main drivers for choice of incorporation are shareholders and directors.⁴⁸ These constituencies are least likely to receive a dividend on insolvency. They are therefore least likely to care about transaction costs arising in insolvency process.⁴⁹ Accordingly, differences in transaction costs are likely to be irrelevant for a market for incorporation.

⁴⁰ D Cabrelli, “Statutory derivative proceedings in Scotland: a procedural impasse?” (2009) 13 EdinLR 511; D Cabrelli, “Statutory derivative proceedings: the view from the Inner House” (2010) 14 EdinLR 116.

⁴¹ A M Gray, “The statutory derivative claim: An outmoded superfluousness?” (2012) 33 CoLaw 295.

⁴² See The Insolvency (England and Wales) Rules 2016, SI 2016/1024 for England and Wales and Insolvency (Scotland) (Receivership and Winding Up) Rules 2018, SI 2018/347 and Insolvency (Scotland) (Company Voluntary Arrangements and Administrations) Rules 2018, SI 2018/1082 in Scotland.

⁴³ D McKenzie-Skene, “‘It’s the rules, Jim, but not as we know them’: the new Scottish corporate insolvency rules” (2019) 32(4) *InsolvInt* 153.

⁴⁴ Insolvency Act 1986, s 132; A Keay, *McPherson & Keay’s Law of Company Liquidation*, 4th edn (2017) at para 8-126.

⁴⁵ See D McKenzie-Skene, *Bankruptcy* para (2017) at para 4-56.

⁴⁶ Insolvency Act 1986 s 178.

⁴⁷ See *Joint Liquidators of the Scottish Coal Co Ltd, Noters* [2013] CSIH 108; D P S Sellar, “When does the English liquidation regime govern land in Scotland?” [2017] SLT 195.

⁴⁸ F H Easterbrook and D R Fischel, *The Economic Structure of Corporate Law* (1991) at 112.

⁴⁹ See M J White, “Corporate Bankruptcy” in P Newman (ed), *The New Palgrave Dictionary of Economics and the Law*, vol 1 (1998) at 483; M J White, “Corporate Bankruptcy as a

Third, the law of execution of documents by companies differs between English and Scots law.⁵⁰ However, the relevant rules apply whenever a UK company (of any jurisdiction) executes a document governed by the relevant applicable law. Parties generally have flexibility to choose the governing law of their contractual relations, which tends to provide Scots law with a disadvantage.⁵¹ This flexibility has its limits,⁵² but applies regardless of incorporation. As such, any transaction costs caused by this difference would affect parties doing business in a jurisdiction,⁵³ rather than driving jurisdiction of incorporation. Fourth, minor differences exist for duties of directors. Whilst under English law, directors have a duty to disclose any wrongdoing to the company,⁵⁴ it seems unlikely that they do under Scots law.⁵⁵ The relevant Scottish case has been criticised for aligning to English law more than was necessary, to the exclusion of Scots law principles which should have applied.⁵⁶ This is a minor difference: if anything, it would make directors more likely to push for incorporation in Scotland rather than less, as they have one duty less under Scots law. Fifth, differences also exist in respect of remedies available to the company when faced with a breach of duty by a director. This is because the 2006 Act leaves such matters to the common law.⁵⁷ As such, general differences between English and Scots contract law in respect of remedies are reflected in such remedies. For example, any preference by English courts to consider damages as the primary remedy will be

Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructurings” (1994) 10(2) JLEcon&Org 268.

⁵⁰ Companies Act 2006 ss43-47 for English law governed documents; Companies Act 2006 s48 for Scots law governed documents; Bennett (n 5) at para 162.

⁵¹ P S Hodge, “Does Scotland need its own Commercial Law?” (2015) 19 EdinLR 299; H L MacQueen, “Quo Vadis?” [2017] JurRev 9.

⁵² e.g. *Rangers Football Club plc, Noters* [2012] CSOH 55.

⁵³ *Hardman* (n 1) at 52.

⁵⁴ *Item Software (UK) Limited v Fassihi* [2004] IRLR 928.

⁵⁵ *Commonwealth Oil & Gas Company Limited v Baxter* [2009] CSIH 75 at [82].

⁵⁶ N R Whitty, “The ‘No Profit from Another’s Fraud’ Rule and the ‘Knowing Receipt’ Muddle” (2013) 17 EdinLR 37.

⁵⁷ Companies Act 2006 s 178.

reflected in the relevant company law remedy.⁵⁸ Conversely, any preference by Scots courts to consider specific implement as the primary remedy⁵⁹ will be reflected in the relevant company law. It is submitted that as the trigger for wrongdoing is (subject to point four above) the same between the two regimes, the disciplinary function of the regime is, ultimately, the same in England as in Scotland. As such, whilst differences as to preferred remedy, and quantification of remedy, are major between the two jurisdictions, their effect on choice of incorporation is likely to be minor.

Sixth, the biggest difference is ease of taking security over shares. A fixed charge can be taken over shares in an English company by way of an equitable charge created by delivering a share certificate and stock transfer form.⁶⁰ However, under Scots law it is necessary to complete the transfer in favour of the creditor to create a fixed security.⁶¹ The author's 2017 article noted anecdotal evidence that this was driving contractual restrictions on corporate borrowers incorporating Scottish subsidiaries.⁶² Proposals have been created to modernise the law of taking security over shares by allowing the creation of a subordinated real right in shares.⁶³ These proposals have received universal acclaim.⁶⁴ This should resolve an area which "has been noticeably unsatisfactory, and has long been

⁵⁸ Morse et al (n 5) at para 8.3306.

⁵⁹ T B Smith, *A Short Commentary on the Law of Scotland* (1962) at 854; A Smith, "Specific Implement" in K G C Reid and R Zimmerman (eds) *A History of Private Law in Scotland* vol 2 (2000) at 195. Cf W W McBryde, *The Law of Contract in Scotland*, 3rd edn (2007) at paras 23-08 – 23-09.

⁶⁰ See R Goode and L Gullifer, *Goode and Gullifer on Legal Problems of Credit and Security*, 6th edn (2017) at para 6.46; F Tregear, "Taking shares in companies as collateral: an uncalculated risk" (2016) 4 JIBFL 205.

⁶¹ See J Hardman, "Scottish Share Pledges and recent legislative developments: Lessons for the Great Repeal Bill" [2018] JurRev 64; *Enviroco v Farstad* [2011] UKSC 16.

⁶² Hardman (n 1) at 30-31.

⁶³ Report on *Moveable Transactions* (Scot Law Com No 249, 2017).

⁶⁴ A D J MacPherson, "The Future of Moveable Security in Scots Law? Comments on the Scottish Law Commission's Report on Moveable Transactions" [2018] JurRev 98; J Hardman, "Three steps forward, two steps back: A view from corporate security practice of the Moveable Transactions (Scotland) Bill" (2018) 22 EdinLR 266.

recognised as such”.⁶⁵ The effect of this is limited to subsidiaries: and therefore not likely to affect listed companies, or parent companies generally.⁶⁶ This therefore cannot, on its own, explain the drop in Scottish incorporated companies being listed in London.

Seventh, whilst English law recognised the floating charge at common law,⁶⁷ Scots law required a statutory intervention to do so.⁶⁸ The author previously included the floating charge as part of the “debt” aspect of internal finance,⁶⁹ but there are arguments that the floating charge is best seen as part of the jurisdiction’s corporate insolvency framework rather than as a right in security.⁷⁰ Since its introduction, the floating charge has been contentious in Scots law.⁷¹ Differences exist at the margin – under English law it is possible to contractually vary the point in time at which the floating charge crystallises into a series of fixed charges,⁷² whereas in Scotland it is not.⁷³ Similarly, an attempted fixed charge, which fails to meet the relevant property law requirements, can be recharacterised as a floating charge under English law,⁷⁴ whereas under Scots law it cannot.⁷⁵ Nonetheless, it is

⁶⁵ Grier (n 6) at para 1-29.

⁶⁶ See discussion in Hardman (n 7).

⁶⁷ See the historical discussion in *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28; R Pennington, “The genesis of the floating charge” (1960) 23 MLR 63.

⁶⁸ *Carse v Coppen* 1951 SC 233; Hardman (n 1) at 49 – 50; R B Jack, “The coming of the floating charge to Scotland: an account and an assessment” in D J Cusine (ed) *A Scots Conveyancing Miscellany* (1987).

⁶⁹ Hardman (n 1) at 49.

⁷⁰ A D J MacPherson, *The Floating Charge* (2020) at Ch 6; J Hardman, “Hohfeld and the Scots Law Floating Charge” in J Hardman and A D J MacPherson (eds) *Floating Charges in Scotland: New Perspectives and Current Issues* (forthcoming).

⁷¹ See G L Gretton, “Should floating charges and receivership be abolished?” [1986] SLT (News) 325; D Cabrelli, “The case against the floating charge in Scotland” (2005) 9 EdinLR 407.

⁷² Cheng Han Tan, “Automatic crystallisation, de-crystallisation, and convertability of floating charge” [1998] Company Financial and Insolvency Law Review 41; B Collier, “Conversion of fixed charge to a floating charge by operation of contract?” (1995) 4 American Journal of Comparative Law 488.

⁷³ Hardman (n 1) at 49; MacPherson (n 70) at paras 3-12 – 3-16. Under Scots law, a floating charge attaches rather than crystallises.

⁷⁴ *Spectrum Plus Ltd (In Liquidation)* [2005] UKHL 41.

⁷⁵ *Clark v West Calder Oil Co* (1882) 9 R 1017; A J P Menzies, “Is the creation of a floating charge competent to a limited company registered in Scotland?” (1909) 21 JurRev 87.

argued that the floating charge is functionally the same under the two jurisdictions.⁷⁶ Major reforms, which would have created such a difference, have been proposed.⁷⁷ It is now, though, thought that such changes will not be effected.⁷⁸ As such, whilst differences exist between the two jurisdictions in the operation of the floating charge, they are minor and unlikely to incur significant transaction costs. Accordingly, of seven acknowledged differences between English and Scottish company law, all but one are minor. The material issue, difficulty in taking security over shares, is not a key driver of incorporation of parent companies. It therefore cannot explain why the Scottish corporate form is being eschewed for listings in London. As such, transaction cost differences arising under known differences between English and Scots company law cannot be said to drive jurisdiction of incorporation.

C. SUPPLY: IMPLICIT DIFFERENCE

However, the difference between England and Scotland in the law of moveable transactions reveals a wider, implicit difference: the nature of a share differs between English law and Scots law. Early English cases held that owning a share gave a shareholder an equitable right in the assets owned by the company.⁷⁹ This was held not to be the case by the mid-nineteenth century, with English law holding in the case of *Borland's Trustees v Steel Brothers* that “A share is...an interest measured by a sum of money and made up of various

⁷⁶ Hardman (n 1) at 49.

⁷⁷ See Bankruptcy and Diligence (Scotland) Act 2007, s 37.

⁷⁸ A J M Steven and H Patrick, “Reforming Secured Transactions Law in Scotland” in L Gullifer and O Akseli (eds), *Secured Transactions Law Reform* (2016) at 263.

⁷⁹ *Child v Hudson's Bay Co* 1723 24 ER 702.

rights contained in the contract”.⁸⁰ The 2006 Act provides that shares are “personal property (or, in Scotland, moveable property)” – rather than heritage.⁸¹

The *Borland’s Trustees* formulation remains the classic English law formulation.⁸² It seems somewhat lacking: it identifies that a share provides contractual rights which are based on a quantum of money, but the case held that it was not akin to holding a debt at all. In 1989, Pennington attempted to provide clarity on the issue, noting that analysis into the nature of a share “is something which textbooks have rarely attempted”.⁸³ He went on to state that, whilst disappointingly vague, the conclusion to be reached was that shares are intangible moveable property which does not constitute a debt.⁸⁴ Accordingly, for Pennington, there was a lack of clarity as to what a share was, but that did not matter for legal analysis. Owning a share provided its holder with some contractual rights, some proprietary rights and was not a debt. Ireland contends that this does not provide enough clarity, arguing that this definition results in shareholders being purely external to the company.⁸⁵

Thus we have a lack of conceptual clarity at the heart of what a share fundamentally is under English law. We also have a conclusion that, ultimately, a share provides a mixture of property and contractual rights.⁸⁶ As such, owning a share provides its owner with a chose in action under English law.⁸⁷ The Scots law equivalent is, of course, incorporeal

⁸⁰ *Borland’s Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279 Ch D; (n 6) at para 5-02.

⁸¹ Companies Act 2006 s 541. This is relevant for the purpose of succession law – see Morse et al (n 5) at paras 6-002 – 6-003. See also H MacQueen and Lord Eassie (Eds), *Gloag and Henderson: The Law of Scotland*, 14th edn (2014) at para 46.22.

⁸² See Davies and Worthington (n 5) at para 23-2.

⁸³ R Pennington, “Can shares in companies be defined?” (1989) 10 CoLaw 140 at 140.

⁸⁴ *Ibid* at 144.

⁸⁵ P Ireland, “Company Law and the Myth of Shareholder Ownership” (1999) 62 MLR 32 at 46.

⁸⁶ R Grantham, “The Doctrinal Basis of the Rights of Company Shareholders” (1998) 57(3) CambLJ 554.

⁸⁷ See Davies and Worthington (n 5), para 23-1; Companies Act 2006 s 541.

moveable property.⁸⁸ The rules between the two are different – mostly arising from the fact that English law considers equity a distinct source of law.⁸⁹ Gower's Company Law, the leading UK company law text, states that upon delivery of a signed stock transfer form and share certificate from a seller to the buyer, and payment of the price to the seller, beneficial interest in the shares transfers from the seller to the buyer. As such "the seller then becomes a trustee for the buyer and must account to him for any dividends he receives and vote in accordance with his instructions".⁹⁰ Thus the share's ownership is split into legal ownership (held by the seller) and beneficial ownership (held by the buyer). The practical importance of the transfer of the beneficial interest is that if the seller then becomes insolvent then the beneficial ownership in the property has already passed.⁹¹ This concept of beneficial ownership arises from the English rules regarding equity.⁹² This is an English law analysis rather than an analysis which is of universal application to Scots law and English law. It is arguable that this analysis is based on an English law concept of a constructive trust.⁹³

Scots law has occasionally recognised a constructive trust.⁹⁴ However, to do so is uncomfortable. In particular, the terms of the Scots law of constructive trusts differ from English law.⁹⁵ The Scots case of *Stevenson v Wilson* held that a constructive trust applied in the context of a share sale.⁹⁶ It is on this basis that the Stair Memorial Encyclopaedia

⁸⁸ For example, see G L Gretton and K G C Reid, *Conveyancing*, 5th edn (2018) at para 3.01; Companies Act 2006 s 541.

⁸⁹ See Discussion Paper on *Moveable Transactions* (Scot Law Com DP No 151, 2011) at Appendix B, paras 2 – 5.

⁹⁰ Davies and Worthington (n 5) at para 27-8. For discussion of the legal effect of a certificate in respect of shares in Scottish companies, see MacQueen and Lord Eassie (n 81) at para 48.18.

⁹¹ For an example in the context of the proceeds of sale of goods, see *Aluminium Industrie Vaassen B.V. v Romalpa Aluminium Ltd* [1976] 1 W.L.R. 676 (CA).

⁹² Davies and Worthington (n 5) at para 27-9; see also discussion in *Pettitt v Pettitt* [1970] AC 777.

⁹³ See A Hudson, *Equity and Trusts*, 9th edn (2017) at para 12.6.

⁹⁴ *Commonwealth Oil & Gas v Baxter* [2009] CSIH 75.

⁹⁵ L Macgregor, *The Law of Agency in Scotland* (2013) at paras 6.39-6.40.

⁹⁶ *Stevenson v Wilson* 1907 SC 445.

concludes that Scots law follows English law.⁹⁷ However, this is fact specific, as that case had a particularly complicated and bad tempered background. There, a trustee of a sequestered estate had successfully reclaimed shares in a private company from a purchaser. This occurred because the initial transfer was challengeable under then-applicable insolvency legislation. It caused considerable ill feeling due to the trustee's allegedly defamatory statements.⁹⁸ After the trustee recovered the shares, they then sold the same shares to the same purchaser. However, the articles in the underlying company gave the directors authority to refuse any share transfer.⁹⁹ The directors exercised this authority. When the directors refused, the trustee refused to either return the sale proceeds or hand over dividends, and was consistent and resolute in such refusal.¹⁰⁰ Both parties agreed that the "beneficial" interest had transferred to the purchaser as a result of the second sale.¹⁰¹ At first instance, Lord Salvesen refused to declare that the shares were held on trust by the seller generally. However, he did agree with the buyer's suggestion that such shares should be held on trust by the seller for as long as the seller remained the registered holder of such shares. Lord Salvesen's reason for such outcome was that the trustee's own conduct meant that he "has himself entirely to blame".¹⁰²

This judgment was upheld on appeal, but the Inner House changed the emphasis. They held that the seller's remedy if the company refused to register the transfer was to annul the transaction by returning funds. Only because the seller refused to return the relevant funds was such a "quasi-trust" necessary.¹⁰³ Accordingly, the Inner House held not that there was

⁹⁷ Bennet (n 5) at para 97.

⁹⁸ *Stevenson v Wilson* (1903) 5 F 309.

⁹⁹ *Stevenson v Wilson* 1907 SC 445 at 447.

¹⁰⁰ *ibid* at 447.

¹⁰¹ *ibid* at 448. As is noted below, this agreement as to the passing of the beneficial interest does not actually square with Scots law.

¹⁰² *ibid* at 452.

¹⁰³ *ibid* at 455-456.

a trust, but that the seller's attitude resulted in them assuming a "quasi-trustee" role. Since then, courts have tried to minimise the role of *Stevenson v Wilson*. In 1932, Lord Moncrieff stated that the proposal that a trust was automatically created over shares when a contract was entered into and all steps other than registration were completed was "unsound". This narrowed the importance of *Stevenson v Wilson* to "very special circumstances".¹⁰⁴ Lord Penrose agreed when *Sharp v Thomson* was decided in the Inner House.¹⁰⁵

Gretton states of *Stevenson v Wilson*, "if it is a case of constructive trust, [it] has been so distinguished and questioned by subsequent case-law that it is now, as they say, 'authority only on its own facts'".¹⁰⁶ We can therefore conclude that *Stevenson v Wilson* does not provide authority for a general rule of constructive trusts in share transfers under Scots law that aligns to English law. Instead, principles from *Stevenson v Wilson* only apply in exceptional circumstances.

This is not surprising given Scots law's unititular nature:¹⁰⁷ the share is, at any time, either "owned" by the buyer or the seller. This means the agreement of the parties in *Stevenson v Wilson* that beneficial ownership had passed to the purchaser was inaccurate as a matter of law. As shares are a form of incorporeal moveable property under Scots law they are transferred by assignation.¹⁰⁸ Scots law has long held that no special form of assignation is necessary.¹⁰⁹ The general rule for assignations is that they are not completed, and ownership of the property in question does not pass to the buyer, until intimation.¹¹⁰ A

¹⁰⁴ *National Bank of Scotland Glasgow Nominees Ltd v Adamson* 1932 SLT 492 at 495 – 496.

¹⁰⁵ *Sharp v Thomson* 1995 SC 455 at 481. This point was not subject to the appeal to the House of Lords.

¹⁰⁶ G L Gretton "Constructive Trusts I" (1997) 1 EdinLR 281 at 286-287.

¹⁰⁷ MacQueen and Lord Eassie (n 81) at para 30-01.

¹⁰⁸ R Anderson, *Assignation* (2008) at Ch 2.

¹⁰⁹ *Carter v McIntosh* (1862) 24 D. 925 at 933.

¹¹⁰ *Christie, Owen and Davies Plc v Campbell* 2009 S.C. 436 at [13]; Anderson (n 108) at ch 6.

Scottish court once stated that English and Scots law “start from diametrically opposite bases” when it comes to the transfer of moveable property.¹¹¹

A transfer of shares cannot be completed until a form of instrument which can be stamped has been so stamped.¹¹² Scots law does not acknowledge beneficial ownership as a concept per se, and its rules on a constructive trust over shares differ from English law. As a result, under Scots law the seller will (other than in unusual circumstances) remain the owner of all aspects of the relevant shares until such procedure has been complied with and the company’s internal register has been updated to reflect the transfer. This is coherent with the transfer of Scots heritable property,¹¹³ and also for Scots property law more widely.¹¹⁴

This represents a considerable difference between English and Scots law on the intervening insolvency of the seller. Under English law, beneficial interest passes to the buyer upon closing and therefore intervening insolvency of the seller does not affect the buyer’s beneficial ownership. Under Scots law, however, all ownership remains with the seller until the company books are written up to reflect the transfer other than in exceptional circumstances. In *Stevenson v Wilson*, the Inner House’s preferred resolution was to provide the buyer with a personal right against the seller, not a real right in the asset.¹¹⁵ The only obligations on a seller are personal and do not create any form of actual trust. The matter is confused as the seller in *Stevenson v Wilson* was the trustee in bankruptcy, rather

¹¹¹ *Macpherson’s Judicial Factor v Mackay* 1915 SC 1011 at 1015; Anderson (n 108) at para 7-31.

¹¹² Companies Act 2006 s 770 and the English case of *Re Paradise Motor Co* [1968] 1 W.L.R. 1125.

¹¹³ See *Burnett’s Trustee v Grainger* [2004] UKHL 8.

¹¹⁴ G L Gretton, “Equitable Ownership in Scots Law?” (2001) 5 EdinLR 73.

¹¹⁵ Which is consistent with Scots law – see *ibid* at 79.

than an unsequestrated person transacting.¹¹⁶ As the transfer of shares involves a time lag as HMRC processes stamp duty payment, this causes a structural flaw when acquiring Scottish shares.¹¹⁷ This affects the point in time at which the buyer obtains a real right in the asset. This differs between the two jurisdictions. Proposed amendments to assignments of incorporeal moveable property under Scots law are limited to assignation of claims. They expressly do not cover the transfer of shares¹¹⁸ and so will not affect this analysis.

The Scots law approach creates higher transaction costs in buying shares, which is likely to affect the attractiveness of investing in the jurisdiction. Accordingly, explicit company law differences do not show large risks of transaction costs. However, the implicit concept which creates a key explicit difference places Scots law at a distinct disadvantage to English law.

¹¹⁶ This narrows the importance of the real/personal rights distinction, as liabilities incurred by the trustee in bankruptcy (or sequestration) were and still are paid out of the estate in priority to other claims (Bankruptcy (Scotland) Act 1856 s LVII and Bankruptcy (Scotland) Act 2016 s 129 respectively). Accordingly, obligations owed by a trustee in bankruptcy are paid in priority to all other obligations, so for a monetary amount will be (so long as the estate contains sufficient assets to cover the claim) functionally the same as having a real right to an equivalent amount. If the seller in *Stevenson v Wilson* was unsequestered, the distinction between the buyer becoming a beneficiary of a quasi-trust and the buyer having a personal right against the seller would be vital. This may be responsible for the laxness in language in *Stevenson v Wilson* which still causes such confusion. Certainly, modern statements on the issue tend to highlight that the primary remedy is a personal right, and only if the transferor refuses to admit such personal right does the secondary remedy, some form of quasi-trust relationship, arise (see MacQueen and Lord Eassie, (n 81) at para 46.18). This is a valiant attempt to reconcile the confusion arising from *Stevenson v Wilson*, but raises more issues than it answers (such as: when such switch occurs; what happens if the transferor acknowledges the personal right, but delays effecting the transfer; what happens if the transferor ignores the issue and neither affirms nor repudiates such personal right). It is submitted that it is conceptually clearer to acknowledge that only a personal right arises.

¹¹⁷ Stock Transfer Act 1963, s 770. This can be avoided by the seller declaring themselves as trustee over the shares in favour of the buyer. However, trustees are personally liable to a company for unpaid amounts due on such shares *Muir v City of Glasgow Bank*, (1879) 6 R. (HL) 21.

¹¹⁸ Report on *Moveable Transactions*, (Scot Law Com No 249, 2017) vol 1 at para 3.4. The pledge of shares in security is, of course, covered by the project – see vol 2 at ch 17 – however, this is obviously a different point to the actual transfer of shares.

This example illustrates a wider difference – a number of areas of company law are based on private law concepts. Any differences between legal systems for these concepts unveils a further implicit difference. Indeed, this was how the fourth known difference arose.¹¹⁹ This issue is therefore widespread across company law wherever a company law concept derives from a private law concept which is different between English and Scots law. Scots law's transaction cost disadvantage from such implicit differences is higher than was the case for explicit differences. As such, it is more likely that such implicit differences may drive the choice of incorporation.

D. SUPPLY: UNCERTAIN DIFFERENCES

In addition to known differences and implicit differences, there are some areas of company law which arise from English law jurisprudence. These create uncertainty as to whether Scots law fully aligns in such areas.

For example, even though the nature of a share differs between the two jurisdictions, it does not seem as though methods of shareholder voting are. Procedures for written resolutions apply equally to England and Scotland,¹²⁰ and rules pertaining to voting by proxy, special resolutions and ordinary resolutions are similarly uniform.¹²¹ All can be supplemented by the articles of association of the company. This applies equally to Scotland and England.¹²²

However, the Companies Act 2006 states that the rules set out do not affect

any enactment or rule of law as to (a) things done otherwise than by passing a resolution, (b) circumstances in which a resolution is or is not treated as having been

¹¹⁹ See sources cited at (n 55) and (n 56).

¹²⁰ Companies Act 2006 s 288.

¹²¹ Companies Act 2006 ss 282-285A.

¹²² E.g. Companies Act 2006 s 22; *Bushell v Faith* [1970] AC 1099.

passed, or (c) cases in which a person is precluded from alleging that a resolution has not been duly passed.¹²³

This is held to be a reference to the “Duomatic Principle”.¹²⁴ This principle takes its name from *In re Duomatic Ltd*.¹²⁵

This principle effectively allows informal unanimous shareholder consent to equate to a formal resolution correctly passed. There were proposals to codify this principle in the Companies Act 2006,¹²⁶ but no codification occurred. It has been criticised as “a principle without form”, whose flexibilities are also its weaknesses.¹²⁷ It has also been argued that the Duomatic Principle “sits uncomfortably alongside many of the central principles of company law”.¹²⁸ More pertinently for our purposes, it is a particularly English construct.

At first, it is difficult to identify the “English only” elements to the principle. Buckley J suggested a two stage analysis to a putative application of this principle – first, could the general meeting carry the matter in question into effect, and second, can it be shown that all shareholders have assented to such matter?¹²⁹ The first question seems to be straightforward enough – a provision will be capable of being carried by the general meeting if the rule exists only to benefit the shareholders. Thus the Duomatic principle has been applied to ratification of breaches of directors' duties,¹³⁰ approval of substantial

¹²³ Companies Act 2006 s 281(4).

¹²⁴ Davies and Worthington (n 5) at para 15-15.

¹²⁵ *In re Duomatic Ltd* [1969] 2 Ch 365.

¹²⁶ Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report*, July 2001, URN 01/942 and URN 01/943 at para 2.14.

¹²⁷ J Ellis, “Unanimous consent of shareholders: a principle without form?” 2011 CoLaw 260.

¹²⁸ R Grantham, “The Unanimous Consent Rule in Company Law” (1993) 52 CambLJ 245 at 271.

¹²⁹ *In re Duomatic Ltd* [1969] 2 Ch 365 at 373.

¹³⁰ *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258; *Sharma v Sharma* [2013] EWCA Civ 1287.

property transactions with directors,¹³¹ and establishment of a pension scheme for the directors which was not permitted by the articles.¹³² In each case, the relevant rule existed to protect shareholders and shareholders were therefore able to waive the related protections. Conversely, provisions for removing directors “at least in part” benefit the director, precluding the application of the Duomatic principle.¹³³ Similar restrictions on unlawful dividends¹³⁴ and alienating assets on insolvency¹³⁵ existed for the benefit of creditors and so the Duomatic principle could not apply.

However, at the margins there has been confusion as to the putative application of the principle. Such confusion is evidenced by the attempted application of the principle to the share buyback regime. This regime prevents companies from buying back their shares unless a series of tests are satisfied. Some of these tests are substantive (and exist to protect creditors by ensuring that the company will not become insolvent as a result of the buyback) and some are procedural (and exist to ensure shareholders actually make the decision). In *R W Peak Ltd*¹³⁶ it was held that the Duomatic principle could never apply to any element of this regime, including the procedural element. Subsequent courts disagreed, stating that procedural provisions are purely for the benefit of shareholders.¹³⁷ This directly contradicted *R W Peak*.

This conflict is acknowledged. Behrens J acknowledged the conflict, but left its resolution to a case where such conflict would be determinative of the outcome.¹³⁸ Such

¹³¹ Eg see *Re Torvale Group Ltd* [1999] 2 BCLC 605; *NBH Ltd v Hoare* [2006] EWHC 73 (Ch).

¹³² *Re Horsley & Weight Ltd* [1982] Ch. 442.

¹³³ *Bonham-Carter v Situ Ventures Limited* [2012] EWHC 230 (Ch).

¹³⁴ *Aveling Barford Ltd v Perion Ltd* [1989] BCLC 626 at 631.

¹³⁵ *In Re George Newman & Co* [1895] 1 Ch. 674.

¹³⁶ *In Re R W Peak Ltd* [1998] BCC 596.

¹³⁷ *BDG Roof-Bond Ltd v Douglas* [2000] BCC 770 at 783.

¹³⁸ *Peña v Dale* [2004] 2 BCLC 508.

conflict was determinative in *Dashfield v Davidson*.¹³⁹ Here, McCahill J stated that it was a matter to be decided on a transaction-by-transaction basis.¹⁴⁰ This is confused: it must be objectively possible to determine whether a provision is for the benefit of shareholders or not.

The second question, whether all shareholders had shown their consent, also produces confused results. Whilst early cases proceed on the basis of unanimity,¹⁴¹ there are deviations. The court stated in respect of a meeting at which 98.7% of the members attended: “if I had to extend the [Duomatic P]rinciple to the extent necessary to do justice in this case, I would do so”.¹⁴² Similarly, the principle was initially successfully invoked by a 75% shareholder where the remaining shareholder had been liquidated.¹⁴³ Once again, this shows confusion – is unanimity of shareholders required to invoke the Duomatic principle or not?

Both circles can be squared by reconceptualising the Duomatic principle. In *re Barry Artist Ltd*¹⁴⁴ the company petitioned for a reduction of capital despite all shareholders signing the same piece of paper rather than passing the required special resolution. Nourse J stated that other than this the petition was “unobjectionable and ought to succeed”.¹⁴⁵ He was critical of the shareholders passing a written resolution (which was then an invalid way of making such decision) and only approved the reduction because there was evidence that it was time critical. He made it clear he would otherwise have refused the reduction.¹⁴⁶ As such, the Duomatic principle becomes not a matter for the shareholders to apply, but one

¹³⁹ *Dashfield v Davidson* [2008] BCC 222.

¹⁴⁰ *Ibid* at para 127.

¹⁴¹ *Salomon v Salomon & Co*, [1897] A.C. 22; *Re Duomatic Ltd* [1969] 2 Ch 365.

¹⁴² *Niltan Carson Ltd v Hawthorne* (1987) 3 BCC 454 at 475.

¹⁴³ *Randhawa v Turpin* [2016] EWHC 2156 (Ch).

¹⁴⁴ *In re Barry Artist Ltd* [1985] 1 WLR 1305.

¹⁴⁵ *Ibid* at 1306B.

¹⁴⁶ *Ibid* at 1306B.

for the court to apply in situations which it deems appropriate to do so. Neuberger J (as he then was) said of the principle in *EIC v Phipps* that its core was whether shareholders' conduct made it "inequitable" to deny they had approved the transaction.¹⁴⁷

Barry Artist and *EIC v Phipps* clarify the Duomatic principle: it is a facet of the English doctrine of equity. It allows a court to review the transaction and establish whether it is equitable for the court to bless the transaction when faced with procedural irregularities. This English concept of equity allowed inconsistent application. This changes the nature of this principle: it is not a tool that the shareholders can use. Instead, it is a tool that the English courts can utilise to allow them to find a just outcome.

All cases cited have been English cases. Duomatic has been cited in four Scottish cases, but was considered to be irrelevant in all without the requirement for any in depth analysis.¹⁴⁸ As a result, we do not know how a Scottish court would treat an attempt to invoke the Duomatic principle. Indeed, viewing the Duomatic principle as an offshoot of equity causes a potential concern for a Scottish court. The unitary nature of Scots law makes equity much less important under Scots law than under English law.¹⁴⁹ Thomson expressed the view that

[i]t is surely the function of Parliament and not the Courts to determine where the balance between the general public interest and the interests of the individual should

¹⁴⁷ *EIC Services Ltd v Phipps*, [2004] 2 BCLC 589, para 122.

¹⁴⁸ *Tayplan Ltd v Smith* [2011] CSIH 8; *Secretary of State v Hamilton* [2015] CSOH 46; *Lander v Premier Pict Petroleum Limited* 1997 SLT 1361; *William Grant v Mercer* [2010] CSOH 52 at para 20.

¹⁴⁹ See *National Exchange Co. v Drew* (1855) 2 Macq 103 at 148; *Forrest and Barr v Henderson* (1869) 8 M 187 at 195; *Allen v M'Combie's Trs* (1909) SC 716 at 717; D Walker, "Equity in Scots Law" (1954) 66 JurRev 103. This section is heavily indebted to D J Carr, *Ideas of Equity* (2017) at Ch 2.

be drawn. In these circumstances, the scope of equity in modern Scots law will become increasingly insignificant as a source of law.¹⁵⁰

Whitty provided that a key difference between the English and Scots law of equity was that under English law, equity gives effect to the court's conscience, whereas under Scots law the remedy is "subordinate to the right".¹⁵¹ This raises questions as to whether a Scottish court would even acknowledge the concept of the Duomatic principle in Scotland. After all, the cases which have applied, or not applied, the Duomatic principle have done so effectively on the grounds of providing vent to the conscience of the court.

When faced with an attempt to invoke the Duomatic principle, a Scottish court has three fundamental options. First, it could follow the approach outlined above by Grier's Company Law and follow the English jurisprudential path, ignoring that it relies so heavily on equitable concepts. However, given that the presence of these equitable principles means that there is no clear definitive and objective test for the Duomatic principle, it is difficult to establish the way in which a Scottish court would do so. Second, it could decide that the Duomatic principle relies so heavily on English equitable principles that it does not have any place in Scots law. Third, it could attempt to interpret the case law through Scots law principles. We cannot tell which of these three routes a Scottish court would take.

Should the court adopt the second or third routes, there would be a difference between the application of the Duomatic principle in Scotland compared to England. Although we cannot state definitively that this difference exists, there is a potential for this difference to

¹⁵⁰ J M Thomson, "The Role of Equity in Scots law" in S Goldstein (ed) *Equity and Contemporary Legal Developments* (1992) at 923, as quoted in Carr (n 149) at para 2-64.

¹⁵¹ N R Whitty, "Borrowing from English Equity and Minority Shareholders' Actions" in E Reid and D Carey Miller (eds) *A Mixed Legal System in Transition: T.B. Smith and the Progress of Scots Law* (2005) at 103.

exist. We will only know whether it does when a Scottish court attempts to discern objective rules contained in English caselaw – rooted as it is in English equity.

This potential for difference makes Scots law unattractive, and therefore makes Scotland unattractive as a jurisdiction of incorporation. The Duomatic principle saves the costs of requiring formality in corporate affairs, which can save transaction costs. Should Scots law not follow it, then transaction costs would be higher for Scottish companies than English companies. However, this uncertainty is a transaction cost in itself.¹⁵² It is likely to be an unattractive feature for investment in Scottish companies.¹⁵³ Sadly, a lack of certainty as to the precise ambit of legal terms is endemic under Scots private and commercial law.¹⁵⁴ So long as such uncertainty persists as to whether Scots law follows the English rules or provides its own (as yet unknown) rules, avoidable uncertainty exists in Scottish company law. This uncertainty will discourage potential market participants from utilising the Scottish corporate form, and could well be a driver for decline in the use of the Scottish corporate form by a listed company. This uncertainty is, once again, endemic across company law in Scotland. It exists in some form whenever the rules arise from, or are interpreted by, equitable principles. Equity underpins most of English law's conceptualisation of company law – from responsibilities of directors,¹⁵⁵ the role of, and remedies available to, shareholders,¹⁵⁶ and even the approach the courts will take to

¹⁵² R C Ellickson, "The Case for Coase and Against Coaseanism" (1989) 99 YaleLJ 611 at 615.

¹⁵³ I MacNeil, "Uncertainty in Commercial Law" (2009) 13 EdinLR 68.

¹⁵⁴ J Hardman, "Clarificatory evolutionary reform – the importance of the Scottish Law Commission's Discussion Paper on Heritable Securities: Pre-Default" [2020] JurRev 96.

¹⁵⁵ D Kershaw, "Corporate law's fiduciary personas" (2020) 136 LQR 454.

¹⁵⁶ T Cheng-Han and W Meng-Seng, "Equity, Shareholders and Company Law" in P S Davies and J Penner (eds) *Equity, Trusts and Commerce* (2017).

piercing the corporate veil.¹⁵⁷ Accordingly, the transaction cost disadvantage of uncertainty as to Scots commercial law affects the majority of company law.

How does this square with the conception that academics consider company law to be unitary? Market participants are more familiar with English law generally,¹⁵⁸ and most major Scottish law firms have now been bought by English equivalents.¹⁵⁹ As such, market actors have more certainty as to English company law. Mergers and lack of underlying certainty mean law firms are unlikely to be able to provide a definitive legal opinion¹⁶⁰ as to the content of Scots company law. This lack of certainty alone is likely to discourage Scottish businesses from utilising Scottish companies. A normative hope that Scottish courts try to align to English company law¹⁶¹ does not translate to descriptive, doctrinal certainty that Scottish courts will follow English law precedent based on English private law principles. Non-legal uncertainty could produce the same result. Thus political uncertainty in Scotland arising from Brexit¹⁶² or IndyRef2¹⁶³ could also have caused a decline in Scottish incorporated companies being listed on the London Stock Exchange.

E. FRAMEWORK

We have identified that there are differences between English and Scottish company law. Some differences are express, some are implicit, and there is uncertainty as to whether certain rules align between the two jurisdictions. This is, however, not sufficient to argue that the decline in Scottish companies being listed in London arises due to a market for

¹⁵⁷ E C Mujih, “Piercing the corporate veil: where is the reverse gear?” (2017) 133 LQR 322.

¹⁵⁸ Hodge (n 51).

¹⁵⁹ J Hardman, “The Moral Hazard of Limited Liability? An Empirical Scottish Study” (2018) 6 Nottingham Insolvency and Business Law eJournal 3.

¹⁶⁰ MacNeil (n 153).

¹⁶¹ Grier (n 6).

¹⁶² M Schillig, “Corporate law after Brexit” (2016) 27 KLJ 431.

¹⁶³ A Clark, “More Than IndyRef2? The Referendums (Scotland) Act 2020” (2020) 91 PolQ 467.

company law. For such a market to exist, there must be a link between any such different laws and the jurisdiction of incorporation of the company. This link between “jurisdiction of incorporation” and “governing law” is inherent in the initial literature on the market for company law, which arose primarily relating to incorporation taxes.¹⁶⁴ However, the market for incorporation literature expanded to explore more fundamental concepts of company law.¹⁶⁵ This literature was all predicated on the inherent link between jurisdiction of incorporation and governing law. This was most commonly expressed in the notion that Delaware corporate law applies to (and only to) all Delaware corporations.¹⁶⁶ Thus there is no market for company law if participants are able to freely choose the applicable company law at any time. If participants in a Scottish incorporated company can choose English company law to govern their interactions, or if Scots law applies Scots law to all companies, and English law vice versa, regardless of their jurisdiction of incorporation, there is no market for incorporations. Accordingly, for the framework for a market for company law to have a real potential to exist, each of English and Scots law must apply the laws of its incorporation to each company.

The governing law of shares is determined on a *lex situs* basis.¹⁶⁷ Establishing the *lex situs* is conceptually difficult because “owning a share” embodies many related rights which are difficult to disaggregate.¹⁶⁸ To avoid different laws applying to different aspects of share ownership, the *lex situs* of a share is normally stated to be the law of the company’s

¹⁶⁴ Cary (n 24).

¹⁶⁵ For an early discussion, see R K Winter, “State Law, shareholder Protection, and the Theory of the Corporation” (1977) 6 JLS 251.

¹⁶⁶ For example, see R Romano, “The State Competition Debate in Corporate Law” (1987) 8 CardozoLRev 709.

¹⁶⁷ *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)* [1996] 1 WLR 387.

¹⁶⁸ *Brassard v Smith* [1925] AC 371.

jurisdiction of incorporation, but it could be where the share register is kept.¹⁶⁹ This is moot intra-UK, as the register of members must be kept either at the registered office of the company¹⁷⁰ or at a single alternative inspection location.¹⁷¹ Both of these must be in the same jurisdiction as the company's jurisdiction of incorporation.¹⁷² A UK company is domiciled in its jurisdiction of incorporation.¹⁷³ A UK company cannot be re-incorporated elsewhere without incurring the cost of liquidation and creating a new entity.¹⁷⁴ Accordingly, the *lex situs* of shares under the Companies Act 2006 is linked to jurisdiction of incorporation: shares in Scottish companies are governed by Scots law and shares in English companies are governed by English law. Such an analysis is coherent and follows wider decisions as to choice of laws which have enabled global trade.¹⁷⁵ For our purposes, though, it means that a framework exists for a market for incorporation.

F. CONCLUSION

This article set out to explore whether any legal rules could be responsible for the decline in Scottish companies being listed on the London Stock Exchange. It has identified that express differences have low transaction cost disadvantages for Scots law. However, these express differences are based on more implicit and fundamental conceptions that result in wider transaction cost deltas. The implicit difference between English and Scots law is

¹⁶⁹ *Macmillan v Bishopsgate*. See J M Carruthers, *The transfer of property in the conflict of laws* (2005) at para 1-38; M Ooi, *Shares and other securities under the Conflict of Laws* (2003) at para 2-05.

¹⁷⁰ Companies Act 2006 s 114(1).

¹⁷¹ Companies Act 2006 s 1136(1) and Companies (Company Records) Regulations 2008, SI 2008/3006 para 3.

¹⁷² Companies Act 2006 s 114(1)(a), s 114(1)(b) and Companies (Company Records) Regulations 2008, SI 2008/3006 para 3(a) respectively.

¹⁷³ Lord Collins et al (eds), *Dicey, Morris & Collins on the Conflict of Laws*, 15th edn (2018) at para 30-002.

¹⁷⁴ Companies Act 2006 s 9(2); Collins et al (n 173) at para 30-003.

¹⁷⁵ *Risdon Iron & Locomotive Works* [1906] 1 KB 49 at 56; *Pickering v Stephenson* (1872) L.R. 14 Eq. 322.

predicated on differences in private law between the two jurisdictions. Uncertainty as to whether English and Scots company law entirely align also arises from different approaches to private law.

Scots law provides that the “creation, operation, operation, regulation and dissolution of types of business association” are matters reserved for the UK Parliament.¹⁷⁶ However, private law is devolved to the Scottish Parliament.¹⁷⁷ This includes all private law concepts outlined in this article. This means that it will become possible, by changing private law, for the Scottish Parliament to indirectly change company law. Such devolved areas are likely to diverge from English equivalent rules over time.¹⁷⁸ It is therefore likely that more doctrinal differences arise over time. This is likely to be more pressing for Scots courts, as they have to navigate between the Scylla of coherence to Scots private law principles at the expense of UK wide company law, and the Charybdis of coherence of UK wide company law to the exclusion of application of Scots private law principles. Indeed, it could be stated that these two aims will constantly be in tension within Scottish company law. Scottish courts have generally struggled to find a neat solution to this conundrum in the context of company law.¹⁷⁹

The issue has become even more pressing. Scottish corporate forms have become less attractive for listing in London.¹⁸⁰ This article has found no “smoking gun” reason for this. However, it has identified that known differences between English and Scots company law create minor transaction cost disadvantages for Scots law, that the implicit differences these

¹⁷⁶ Scotland Act 1998 s 9 and Sch 5, Part II C1.

¹⁷⁷ Scotland Act 1998 s 126(4).

¹⁷⁸ See L Macgregor “Empire, Trade and the use of Agents in the 19th Century: The ‘Reception’ of the Undisclosed Principal Rule in Louisiana Law and Scots Law” (2019) 79 LaLRev 986 at 1042-1043.

¹⁷⁹ E.g. *Anderson v Hogg* 2002 SC 190; Whitty (n 151).

¹⁸⁰ Hardman (n 7).

are built upon create greater transaction cost disadvantages, and that uncertain differences create the biggest transaction cost disadvantages. Unfortunately, such uncertainty is endemic across Scots company law. A framework for a market for incorporations exists. It seems that market participants are using this market – if Scots company law is to avoid falling further behind, it needs greatly clarity, and it needs it now.